S&P Global
Ratings

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Research Update:

Corporacion Andina de Fomento 'AA/A-1+' Ratings Affirmed; Outlook Stable

May 28, 2024

Overview

- We expect Corporacion Andina de Fomento's (CAF) capital position will remain resilient as balance-sheet growth from continued expansion in Latin America and the Caribbean will be accompanied by paid-in capital.
- Our ratings incorporate our expectation that CAF's reduced exposure to Venezuela will likely enter arrears in the second half of 2024 when the mechanism agreed on in 2020 to repay loans with equity runs out.
- S&P Global Ratings affirmed its 'AA' long-term issuer credit rating and 'A-1+' short-term issuer credit rating on CAF. S&P Global Ratings also affirmed its 'AA' rating on CAF's debt outstanding.
- The stable outlook indicates our expectation that CAF will continue supporting member countries and consolidate its reach in the region while managing its capital prudently.

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Rating Action

On May 28, 2024, S&P Global Ratings affirmed its 'AA' long-term foreign currency and 'A-1+' short-term issuer credit ratings on Corporacion Andina de Fomento. S&P Global Ratings also affirmed its 'AA' rating on CAF's debt outstanding. The outlook is stable.

Outlook

The stable outlook reflects our expectation that over the next two years, CAF will continue supporting member countries and strengthen its presence in the region following recent expanded membership and its capital increase, which will also underpin its capital adequacy. We assume that members will continue to treat CAF as a preferred creditor and that it will maintain robust shareholder support through timely capital payments, as well as hold high levels of liquidity. We also expect that CAF will prudently manage its exposure to Venezuela once its liquidity mechanism expires in 2024, without increasing risk on its balance sheet.

Downside scenario

We could lower the ratings if CAF expands its balance sheet significantly beyond our expectation, leading to a weaker capital position. Signs of weakening support from shareholders through delays in capital payments or signs of weaker policy execution could also lead to a downgrade.

Upside scenario

We could raise the ratings if CAF incorporates highly rated shareholders, which could enhance its capital ratio and create more diversity in its governance structure. This assumes members would continue to treat CAF as a preferred creditor amid robust shareholder support as the institution continues to fulfil its countercyclical lending role in the region and maintains high liquidity. An upgrade would also depend on CAF prudently managing its exposure to Venezuela without increasing risk on its balance sheet.

Rationale

Recurrent payment delays from Venezuela starting in 2017 of fewer than 180 days--amid its economic crisis--led to our decision to weaken CAF's preferred creditor treatment (PCT) status, which weighed on the rating. To address the pressures stemming from Venezuela, in March 2020, CAF's shareholders assembly approved a support program for exceptional situations. The program effectively allowed CAF to begin repurchasing Venezuela's equity shares to pay down the debt coming due from the sovereign.

Given that equity does not entirely cover the remaining loan balance, we expect that Venezuela will enter arrears in the second half of 2024 and it is likely to reach nonaccrual status by 2025, as we assume the sovereign will be unable to service its remaining debt in the short term. Venezuela currently represents a small proportion of CAF's balance sheet, at 6.3% of the loan book as of 2023 (from 14% in 2018), limiting the risk to PCT beyond our current assessment that already incorporates this expected event, and the rating. The current calculated arrears ratio is 1.75% and we estimate it will increase to about 5% in 2025 as the remaining loan balance will be about $1.9 billion. By January 2024, CAF had repurchased 151,298 shares, bringing Venezuela's loan balance outstanding to $2.1 billion from $3.5 billion in March 2020.

At the same time, we continue to consider this unusual transaction to be a constraint on our capital adequacy assessment because the reduction in Venezuela's shares used to repay its debt was not compensated by additional capital. Venezuela will only maintain equity in the institution sufficient to remain a full member.

We expect CAF will continue to strengthen its position in the Latin America and the Caribbean region following its most recent capital increase as well as continued expansion in membership. The institution has doubled in size over the past 10 years and intends to sustain its growth pace and keep supporting members as equity is enhanced. Although CAF's scope is more limited than that of larger institutions, members see CAF's value in its proximity to the region and agility in loan approval and disbursements.

CAF stands out among its peers in terms of the frequency of capital increases and shareholder support given its size. The institution's 10th capital increase for $7 billion (all paid-in) approved by the board of governors in March 2022 was the largest in its history. Payments began in 2023 and will gradually ramp up, especially after the remaining $365 million from the ninth general capital increase approved in 2015 is paid in 2024-2025.

CAF will also continue to benefit from expanded support from existing members and the incorporation of new member countries in recent years. Chile became a full member of the institution in March 2023 and will contribute $1.5 billion of paid-in capital. Also in 2023, the Dominican Republic concluded the process to become a full member (and will contribute $310 million), and Honduras joined the institution as a full member, bringing total shareholders to 21 ($460 million). This adds to increased participation from other countries like Mexico and Costa Rica in recent years.

As part of the bank's strategy to expand in the Caribbean, in March 2024, the board approved the allocation of shares for The Bahamas, Dominica, and Grenada, which formally expressed their interest in joining CAF. We view this as a positive development that adds to CAF's enhanced mandate in the broader region and will increase diversification.

During 2023, CAF increased its lending book by 9.3%, reaching $33.3 billion. At the same time, it has been strengthening its role in promoting green growth in the region. The institution targets ramping up approvals for green financing to 40% by 2026 (from about 23% in 2023).

CAF's main areas of focus are infrastructure (43% of the loan book as of 2023); transport warehousing and communications (27%); and electricity, gas, and water supply (16%). With the increase in capital, CAF aims to focus on four areas: become the green bank of Latin America and the Caribbean, support subnational governments, promote regional integration, and strengthen the role of the non-sovereign sector.

Although not its main role, CAF has also been supporting member countries Argentina and Ecuador through an exceptional short-term facility, acting as a bridge before receiving funds agreed with the International Monetary Fund (IMF). Conditions for eligibility depend on a short-term established repayment source, typically from the IMF. CAF has one loan outstanding for $800 million with Ecuador under this framework. Although this creates marginal downward pressure and volatility on the risk-adjusted capital (RAC) ratio, we believe it is neutral for the rating as long as CAF manages these exposures prudently.

We believe that increased capital will bolster the resilience of CAF's RAC ratio, despite vulnerabilities in the region. The RAC ratio was 17.9% as of December 2023, down from 18.3% in December 2022, mainly due to increased exposure to Argentina for $960 million under the exceptional short-term facility (which was repaid in February 2024). Continued growth in capital, partially bolstered by very high net income amid elevated interest rates, and the reduction in Venezuela's exposure, which carries a high capital charge, contributed to RAC levels despite the loan expansion. Upgrades in five countries that represent 34% of total exposure (Argentina, Brazil, Costa Rica, El Salvador, and Paraguay) were partially offset by downgrades in two that represent 14% of exposure (Bolivia and Peru).

We believe CAF's administration will manage balance-sheet growth and capital prudently, especially if rating vulnerabilities emerge owing to weaker sovereign creditworthiness across the region. However, we expect members to maintain a solid track record of PCT with CAF.

The institution has made efforts to diversify its portfolio and recently implemented enhancements to its risk management practices. Its main exposures as of December 2023 are Argentina (16%), Ecuador (13%), Colombia (11%), Brazil (9%), and Bolivia (9%). The most recent capital increase was a key condition to maintain its pace of lending growth to members.

In our view, CAF's governance is constrained by the absence of a set of nonborrowing member countries, which is a weakness compared with higher-rated multilateral lending institutions with greater shareholder diversity. On the other hand, CAF maintains robust risk management practices for its liquidity and derivatives portfolio. We also believe CAF could withstand the loss of key personnel and significant disruptions to operations. While its headquarters are in Caracas, Venezuela, the institution has made important strides over the past few years to decentralize its workforce and has operating systems throughout Latin America.

CAF's liquidity is high. Our calculated 12-month liquidity ratio including loan disbursements was 1.4x as of December 2023, in line with 2022. The six-month ratio was 1.7x as of December 2023. CAF has maintained higher liquidity compared with our additional stress test that considers 50% of all undisbursed loans coming due in the next 12 months. Therefore, we expect it to accommodate unplanned disbursements.

At the same time, CAF has a conservative funding profile, with cumulative assets consistently exceeding cumulative debt for maturities up to one year and no significant gap for five years. We estimate that CAF can cover its scheduled short-term debt liabilities without recourse to new issuance. Its static funding gap (without loan disbursements) was 1.6x at the one-year horizon as of December 2023.

CAF has been diversifying its funding and issuing benchmark bonds, demonstrating robust access to the global markets. Bonds outstanding represented 70% of liabilities in 2023 at $24.8 billion in 18 different currencies. Total market issuance in 2023 reached $6.5 billion, while CAF has issued $5.7 billion so far in 2024, covering most financing needs for the year.

Issuances in local currencies, all hedged, contribute to local market development in different countries through increased options and sources of diversification.

Finally, in terms of shareholder support, we do not include any ratings uplift for extraordinary shareholder support because the sovereign shareholders are rated below CAF's stand-alone credit profile of 'aa'.

Ratings Score Snapshot

Issuer credit rating	**AA/Stable/A-1+**
Stand-alone credit profile	aa
Enterprise risk profile:	Strong
Policy importance	Strong
Governance and management expertise	Adequate
Financial risk profile:	Very Strong
Capital adequacy	Strong
Funding and liquidity	Very Strong
Extraordinary support	N/A
Callable capital:	--
Group support:	--
Holistic approach	--

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational

Institutions Ratings Methodology, Jan. 31, 2022

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Supranationals Special Edition 2023: Capital Optimization At The Forefront For MLIs, Oct. 13, 2023
- Introduction To Supranationals Special Edition 2023, Oct. 11, 2023
- Corporacion Andina de Fomento Long-Term Rating Raised To 'AA' On Stronger Presence In The Region; Outlook Stable, May 23, 2023

Ratings List

Ratings Affirmed	
Corporacion Andina de Fomento	
Issuer Credit Rating	
Foreign Currency	AA/Stable/A-1+
Corporacion Andina de Fomento	
Senior Unsecured	AA
Commercial Paper	A-1+